

Message Text

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R 311545Z MAR 78
FM AMEMBASSY PARIS
TO DEPARTMENT OF TREASURY
SECSTATE WASHDC 9380
INFO AMEMBASSY BONN
AMEMBASSY LONDON
AMEMBASSY ROME
AMEMBASSY TOKYO

C O N F I D E N T I A L SECTION 01 OF 04 PARIS 10710

PASS FEDERAL RESERVE AND COMMERCE

E. O. 11652: GDS
TAGS: EFIN, FR
SUBJECT: FORECAST OF THE FRENCH ECONOMY FOR 1978

REFTELS: (A) PARIS 25252, DATED 8/31/77; (B) PARIS 01154,
DATED 1/13/78; (C) PARIS 1748, DATED 1/19/78;
(D) PARIS 10140, DATED 3/24/78

FOR BONN, PASS HERMBERG; FOR LONDON, PASS AMMERMAN,
FOR ROME, PASS DEFALCO; FOR TOKYO, PASS MCCAMEY

1. SUMMARY:

THE BALANCE OF PAYMENTS AND INFLATION CONSTRAINTS ON
THE FRENCH ECONOMY ANALYZED IN OUR PRELIMINARY FORECAST
FOR 1978 (REFTEL A) CONCLUDED THAT A REAL GROWTH RATE
OF ABOUT 3.5 PERCENT IN 1978 WOULD BE ABOUT THE BEST THE
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FRENCH ECONOMY COULD POSSIBLY DO. RECENT ANALYSIS BY
INSEE (REFTEL D) CONFIRMS FROM A TECHNICAL VIEWPOINT
THAT THE FRENCH ECONOMY HAS VERY, VERY LITTLE ROOM FOR
MANEUVER IN THE 1978--79 PERIOD SINCE A REAL GROWTH
RATE NEAR OR OVER 4 PERCENT WOULD DESTABILIZE THE
ECONOMY IN BALANCE OF PAYMENTS AND INFLATION
TERMS. GIVEN THE FACT THAT GROWTH IN THE FIRST QUARTER

OF 1978 HAS BEEN ALMOST CERTAINLY NO MORE THAN 0.5 PERCENT, A GROWTH RATE MOVING TOWARD 1.0 PERCENT A QUARTER DURING THE SECOND HALF OF 1978 WOULD PRODUCE AN ANNUAL GROWTH OF ABOUT 3.3 PERCENT. THIS SEEMS TO BE THE MOST LIKELY OUTCOME, GIVEN THE ASSUMPTIONS NOTED BELOW. WITH A GROWTH RATE APPROACHING A 4 PERCENT ANNUAL RATE DURING THE SECOND HALF OF 1978, LITTLE, IF ANY, IMPROVEMENT CAN BE EXPECTED IN THE INFLATION RATE ESTIMATED AT JUST OVER 8 PERCENT ON A GNP DEFLATOR BASIS AND ABOUT 8.7 PERCENT ON A CPI BASIS. THE TRADE BALANCE PROBABLY WILL WORSEN SOMEWHAT FROM THE 1977 DEFICIT OF 13 BILLION FRANCS TO ABOUT 16 BILLION FRANCS FOR 1978. END SUMMARY

2. ASSUMPTIONS:

(A) GLOBAL DEMAND AT ROUGHLY A 6 PERCENT ANNUAL GROWTH RATE;

(B) AN OIL PRICE INCREASE OF NO MORE THAN 5 PERCENT BETWEEN NOW AND THE END OF 1978;

(C) FRENCH FRANC/DOLLAR EXCHANGE RATE WITHIN RANGE OF 4.60 TO 4.90 DURING 1978;

(D) NO BASIC CHANGE IN FISCAL AND MONETARY POLICY FROM
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THAT PRESENTED IN THE 1978 BUDGET;

(E) AN INCREASE IN SOCIAL TRANSFER PAYMENTS TO BENEFIT LOW INCOME WORKERS, EMPLOYMENT OF YOUTH, AND OLD AGE WELFARE, ALONG WITH A WAGE POLICY WHICH ACCEPTS A REAL WAGE INCREASE OF BETWEEN 2 AND 3 PERCENT FOR SALARIED WORKERS. THIS POLICY WILL PUSH THE FISCAL PARAMETERS OF THE 1978 BUDGET AND PROBABLY WILL REQUIRE A SOMEWHAT LARGER SUPPLEMENTARY BUDGET NEXT SEPTEMBER THAN IMPLIED IN THE ORIGINAL BUDGET PRESENTATION. THE IMPLICIT INCREASE IN TREASURY DEBT OPERATIONS AS A RESULT OF THESE ACTIONS PROBABLY CAN BE FINANCED WITHIN OR CLOSE TO THE MONETARY TARGET OF 12 PERCENT GROWTH BECAUSE NEITHER HOUSEHOLD NOR BUSINESS INVESTMENT OVERALL WILL BE SUCH AS TO TIGHTEN INTEREST RATES, AT LEAST UNTIL THE LAST QUARTER OF 1978.

(F) NO SERIOUS POLITICAL OR SOCIAL PRESSURES.

NOTE: IF THE ABOVE ASSUMPTIONS CHANGE SUFFICIENTLY TO BASICALLY ALTER THE ENVIRONMENT OF THE FRENCH ECONOMY, A REVISED FORECAST WILL BE SUBMITTED.

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3. FORECAST OF THE FRENCH ECONOMY FOR 1978--
ANNUAL RATES OF REAL GROWTH

FORECAST PRELIMINARY
1978 RESULTS 1977

CONSUMPTION	3.6	2.7
PUBLIC CONSUMPTION	4.8	3.0
TOTAL INVESTMENT	0.8	MINUS 1.0
EXPORTS	7.2	6.3
IMPORTS	6.8	1.0
GDP, EX STOCKS	3.0	2.9
ADJUSTMENT FOR STOCKS AS		
PERCENTAGE OF GDP	0.3	N.A.
GDP GROWTH RATE	3.3	N.A.

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4. ESTIMATIONS OF SEASONALLY ADJUSTED ANNUAL REAL GROWTH
RATES BY QUARTER IN 1978:

1ST QTR	2ND QTR	3RD QTR	4TH QTR
0.5	0.8	1.0	1.0

5. BALANCE OF PAYMENTS FORECAST FOR 1978:

BILLIONS OF FRANCS

TRADE BALANCE	MINUS 16
NET SERVICES	PLUS 7
NET TRANSFERS	MINUS 10
CURRENT ACCOUNT	MINUS 19

6. AS REPORTED IN REFTELS, GOF NATIONAL INCOME DATA IS IN A TRANSITION STAGE. AS OF NOW, WE CANNOT CONSTRUCT ON THE BASIS OF DATA AVAILABLE A 1977 BASE FOR FORECASTING PURPOSES AND WILL NOT BE ABLE TO DO SO UNTIL THE NEW GNP SERIES IS AVAILABLE SOMETIME DURING THE SECOND HALF OF THIS YEAR. SINCE OUR 1977 FORECAST OF A 2.9 PERCENT GROWTH RATE IS THE SAME AS INSEE PRELIMINARY RESULTS, NOT INCLUDING STOCKS THE TABLE CONTAINED IN PARA 3 OF REFTEL B HAS BEEN USED TO PRODUCE THE FOLLOWING RESULTS EXPRESSED IN FRENCH FRANCS (1970 PRICES):

1977 PRELIMINARY RESULTS AND 1978 FORECAST,
YEAR TOTALS, BILLIONS OF FRANCS, 1970 PRICES 1/

1977	1978
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TOTAL CONSUMPTION	666.8	690.8
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TOTAL INVESTMENT	238.3	240.2
EXPORTS, INCL. SERVICES	216.1	231.7
IMPORTS, INCL. SERVICES	204.2	218.1
NET FOREIGN BALANCE	11.9	13.6
GDP, EX. STOCKS	917.0	944.6
ADJUSTMENT FOR STOCKS	N.A.	2.7
TOTAL GDP	N.A.	947.3

1/ AS EVIDENT IN THE ABOVE TABLE AND IN THE RATES OF GROWTH TABLE IN PARA 3 ABOVE, CHANGES IN STOCKS HAVE BEEN TREATED AS A POSITIVE RESIDUAL ITEM IN ORDER TO PRODUCE THE ESTIMATED 3.3 PERCENT GROWTH RATE. FRENCH GNP

FIGURES CURRENTLY DO NOT INCLUDE STOCKS, WHICH MUST BE CALCULATED EITHER AS A RESIDUAL ITEM OR EXCLUDED FROM TOTAL GDP. ALSO AS NOTED PREVIOUSLY, THE RELATIVE PRICE CHANGES FOR EXPORTS AND IMPORTS SINCE 1970 MEAN THAT EVEN A FAIRLY LARGE TRADE SURPLUS IN 1970 PRICES TRANSLATES INTO A DEFICIT WHEN MEASURED IN CURRENT PRICES.

7. COMMENTS ON MAJOR COMPONENTS OF GNP:

(A) CONSUMPTION: AS A RESULT OF AN INCREASE IN PURCHASING POWER THAT BEGAN IN THE FINAL QUARTER OF 1977, PARTLY AS THE RESULT OF SOME INCREASE IN WAGES BUT ALSO FROM A SLOWDOWN IN THE RATE OF INFLATION, THE FRENCH CONSUMER CAN BE EXPECTED TO BE THE MAJOR FORCE CONTRIBUTING TO ECONOMIC GROWTH IN 1978. THIS TREND PROBABLY WILL BE REINFORCED BY A MORE LIBERAL WAGE POLICY THROUGHOUT 1978. PUBLIC CONSUMPTION WILL DO ITS SHARE TO ASSIST WHAT LOOKS MORE AND MORE LIKE A CONSUMPTION LED RECOVERY, AT LEAST THROUGH 1978.

(B) INVESTMENT: THE GOF WOULD LIKE MORE INVESTMENT BUT

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IS UNLIKELY TO GET ALL IT WANTS FOR TWO REASONS: FIRST, HOUSEHOLD INVESTMENT, MAINLY IN HOUSING, ACCOUNTS FOR ABOUT ONE-THIRD OF TOTAL INVESTMENT. IT REMAINS VIRTUALLY AT THE RECESSION LEVELS OF 1974--75 IN VOLUME TERMS AND SEEMS MOST UNLIKELY TO RECOVER THIS YEAR. SECOND, SINCE 1974--75 BUSINESS INVESTMENT HAS BEEN CONCENTRATED INCREASINGLY IN SOME INDUSTRIES, NOTABLY AUTOMOTIVE, DURABLE ELECTRONIC CONSUMER GOODS, HEAVY ELECTRICAL, TELECOMMUNICATIONS, AND GLASS WHICH HAVE IMPROVED BOTH THEIR CASH FLOW AND THEIR RATE OF PROFIT, WHILE THE REVERSE IS TRUE FOR VIRTUALLY THE REST OF ALL LARGE SCALE FRENCH INDUSTRY. THE SITUATION IN MEDIUM AND SMALL SIZE FIRMS IS MIXED BUT PROBABLY FOLLOWS A PATTERN SIMILAR TO THAT OF LARGER ENTERPRISES. IN SHORT, IN THESE TERMS THE RICH COMPANIES HAVE BECOME RICHER WHILE THE POOR COMPANIES HAVE BECOME POORER. POOR COMPANIES DON'T INVEST. THEY ADJUST THEIR BOOKS. CONFIDENTIAL

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SO THE INCREASE IN INVESTMENT BY FINANCIALLY STRONG COMPANIES, WHICH COULD BE SUBSTANTIAL IN 1978, WILL NOT BE SUFFICIENT TO OFFSET IN TOTAL TERMS THE EFFECT OF LITTLE IF ANY INVESTMENT BY THE REST OF FRENCH FIRMS PLUS THE ALMOST CERTAIN LACK OF ANY SIGNIFICANT INCREASE IN HOUSEHOLD INVESTMENT. IF THE BROAD LINES OF THE BARRE PLAN ARE HELD THROUGH 1978, THE OVERALL INVESTMENT OUTLOOK COULD IMPROVE CONSIDERABLY IN 1979. BARRE HAS ALWAYS SAID THAT HIS PLAN WOULD TAKE ABOUT THREE YEARS TO BEAR FRUIT, AND THIS SEEMS TO BE A GOOD FORECAST.

(C) EXTERNAL SECTOR: IF GLOBAL DEMAND GROWS BY 6 PERCENT IN 1978, ALL PAST CORRELATIONS SHOW FRENCH EXPORTS WOULD GROW BY ABOUT 7 PERCENT. RECENT EXCHANGE RATE CHANGES HAVE BEEN SO FAVORABLE IN TERMS OF FRENCH EC TRADE THAT FRENCH EXPORTS SHOULD ACHIEVE 7 PERCENT PLUS A BIT EVEN IF GLOBAL DEMAND GROWS BY LESS THAN 6 PERCENT IN 1978. FRENCH IMPORTS GREW BY ONLY 1 PERCENT IN VOLUME TERMS IN 1977, A PHENOMINALLY LOW RATE WHICH CANNOT BE SUSTAINED BECAUSE BOTH INVENTORY CHANGES AND A HIGHER GROWTH RATE WILL WORK TO SHARPLY INCREASE FRENCH IMPORTS IN 1978.

(D) STOCKS: THE ALWAYS OBSCURE SITUATION OF STOCKS HAS
DISAPPEARED FROM SIGHT AS THE RESULT OF ONGOING CHANGES
IN THE SYSTEM OF FRENCH NATIONAL INCOME ACCOUNTS. A
SURVEY IS UNDERWAY WHICH IS SUPPOSED TO ACTUALLY
PRODUCE HARD NUMBERS SHOWING LEVELS OF STOCKS LATER
THIS YEAR OR NEXT. MEANWHILE, IT'S BLIND MAN'S BLUFF
WITH ANY INFORMED GUESS AS GOOD AS ANY OTHER. THUS,
STOCKS CAN ONLY BE TREATED AS A RESIDUAL ITEM IN THE
NATIONAL INCOME ACCOUNTS. BASED ON A COLLECTION OF
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INFORMED GUESSES, WE ESTIMATE THAT STOCKS GENERALLY
ARE AT RELATIVELY LOW LEVELS, THAT THEY WILL RISE,
PARTICULARLY IN THE CASE OF IMPORTED STOCKS, THROUGH
THE THIRD QUARTER OF 1978 AFTER WHICH THEY WILL LEVEL
OFF AND BEGIN A SLOW DECLINE AS THE ECONOMY BEGINS TO
DIGEST THE NEW LEVEL OF STOCKS IMPLICIT IN A SOMEWHAT
FASTER GROWTH RATE. ON BALANCE, STOCKS WILL BE A
POSITIVE ELEMENT IN THE FINAL DEMAND OF THE ECONOMY IN
1978 ENABLING A REAL GROWTH RATE OF ABOUT 3.3 PERCENT
RATHER THAN A marginally lower figure.

8. EMPLOYMENT:

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A 3.3 PERCENT REAL GROWTH RATE IS OBVIOUSLY INSUFFICIENT TO DENT THE UNDERLYING SLOW GROWTH OF UNEMPLOYMENT IN FRANCE. SOCIAL TRANSFER PAYMENTS AND OTHER SPECIAL PROGRAMS DESIGNED TO HELP YOUTH EMPLOYMENT IN 1977 NO DOUBT WILL BE CONTINUED AND PROBABLY INCREASED AS A RESULT, THE LEVEL OF UNEMPLOYMENT MIGHT BE HELD AT ROUGHLY CURRENT LEVELS--I.E., A SHADE OVER 1,000,000; BUT THIS IS ABOUT THE BEST RESULT THAT COULD HAPPEN. A RISE TO ABOUT THE 1,200,000 LEVEL CANNOT BE COUNTED OUT. IN SOCIAL AND POLITICAL TERMS, UNEMPLOYMENT, OR MORE PRECISELY MEASURES TO INCREASE EMPLOYMENT, ARE LIKELY TO BE BY FAR THE NUMBER ONE ECONOMIC ISSUE IN FRANCE IN 1978. WITH ITS TECHNICAL LEVEL ADVISING THE SEVERE CONSTRAINTS INVOLVED IN A HIGHER GROWTH RATE AND ITS POLITICAL LEVEL SENSITIVE TO THE DEMAND FOR JOBS AND A DEMOGRAPHIC PROFILE THAT OFFERS NO REAL RELIEF UNTIL
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THE EARLY 1980'S, THE GOF HAS A SERIOUS ECONOMIC/SOCIAL PROBLEM ON ITS HANDS WITH NO REALLY VIABLE SOLUTION IN SIGHT FOR THE 1978--79 PERIOD. IF ONLY THE INFLATION RATE WERE LOWER, THEN THE GAP BETWEEN THE GROWTH RATE REQUIRED FOR INCREASING EMPLOYMENT AND THE GROWTH RATE REQUIRED FOR BALANCE OF PAYMENTS AND PRICE EQUILIBRIUM MIGHT BE CLOSED. (SEE REFTTEL A FOR AN ANALYSIS OF FRENCH INFLATION AND THE GROWTH RATE DILEMMA.) BUT THE RATES OF GROWTH, INFLATION, EMPLOYMENT, AND THE BALANCE OF PAYMENTS ARE ALL TIED TOGETHER. ONE CANNOT CHANGE WITHOUT CHANGING ALL OF THE OTHERS. FOR THIS REASON, IT IS ASSUMED THAT IF THE GOF CAN SLIDE THROUGH STILL ANOTHER YEAR WITH NO REAL IMPROVEMENT IN UNEMPLOYMENT, IT WILL DO SO RATHER THAN RUN THE CERTAIN RISKS OF ECONOMIC INSTABILITY ASSOCIATED WITH A 5 PERCENT REAL GROWTH RATE WHICH WOULD BE THE MINIMUM RATE REQUIRED TO SUBSTANTIALLY REDUCE UNEMPLOYMENT DURING THE 1978--79 PERIOD.
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